$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

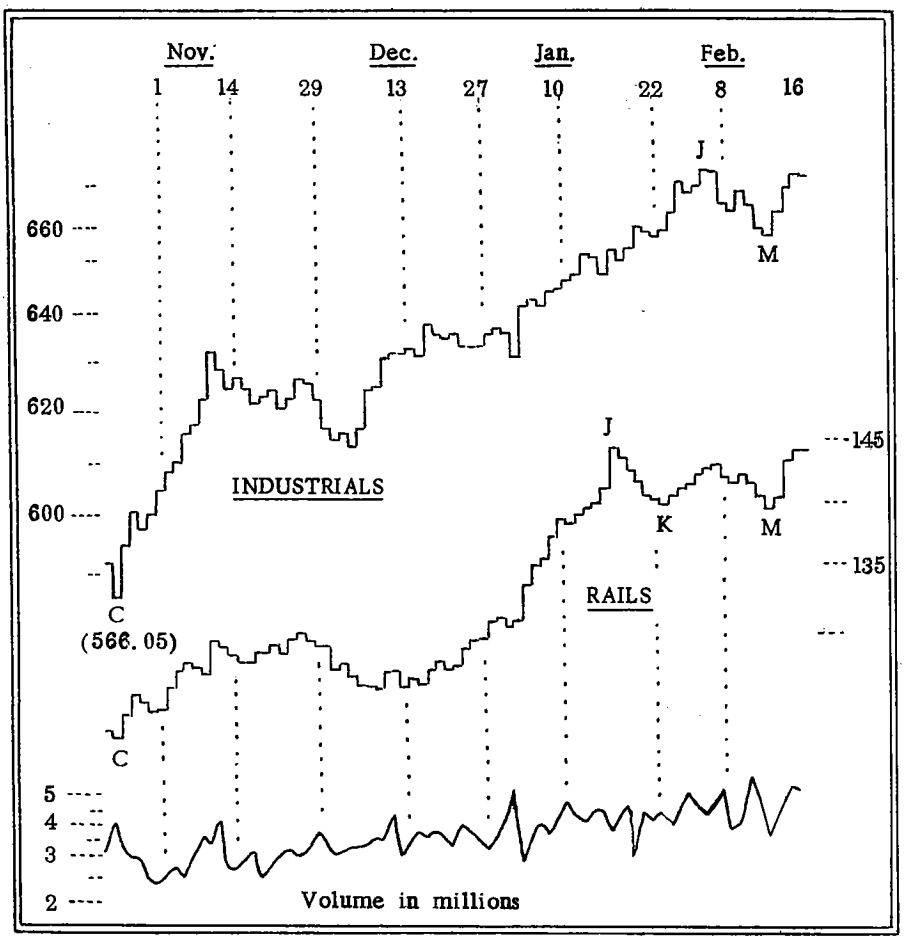
"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission

All Rights Reserved

PRICE MOVEMENTS On February 13 the Rail Average closed 27¢ under the preceding low at K. Volume contracted to 3.56 million shares on the day, however, and this suggested an absence of selling pressure. On the following three days volume expanded with higher prices, but by Friday (February 17) Industrials were still 1.95 points below their preceding peak at J and 4.75 points short of the March, 1960, secondary high (656.42). At the same time Friday found Rails .57 short of the J peak and 2.24 points below the March, 1960, secondary peak of 146.56. With both Averages so close to critical points, it is better to let the market do the "talking" (rather than attempt to "outguess" the Averages).



The implications of a joint bettering of the 1960 secondary highs were discussed in detail in Letter 133. Obviously, a failure of one or both Averages to better the 656.42 and 146.56 peaks would set the stage for a "test" of the preceding lows at M (Industrials 637.04, Rails 139.68). A violation of those lows with accompanying heavy volume would almost certainly mean that the secondary trend had turned down. The primary trend, as stated in the last Letter, must be considered bearish at this time.

DIFFICULT PERIODS For those who base their business and investment decisions on the implications of the Averages, there have been three particularly difficult periods since the "Great Crash" of 1929. These periods were 1938-42, 1946-49 and 1959-61. The 1938-42 period included two abnormally short bull markets, a very short bear market and another bear market which confused everybody by being considerably longer than its preceding bull market (one of the few such instances in history). The 1946-49 period was almost as confusing, consisting of the short but violent bear market of 1946-47, the "baby" bull market of 1947-48, and the equally shallow bear market of 1948-49. Throughout the entire 1946-49 period the Industrial Average remained in the 212-160 range.

We now come to the period which began in late 1959 and has lasted to the present. In August, 1959, Industrials and Rails touched peaks of 678.10 and 173.56 respectively. Following a violent retreat from those highs, the two indicators again advanced, and this time Industrials recorded an all-time high of 685.47 (January, 1960). That new high was not confirmed by Rails, however, and this led to a second sharp decline. When the preceding secondary lows were violated by both Averages (March 3, 1960), a primary bear market was signalled.

The market continued its decline until March 8. A particularly complex (upward) reaction then succeeded in taking Rails to a recovery high of 146.56 (March 25), Industrials to a recovery high of 656.42 (June 9). Following the 146.56 and 656.42 secondary

highs, a third primary downswing established new lows for the bear market at 566.05 and 123.37 (September-October, 1960). From those lows a fresh advance has now taken the Averages directly under the previous secondary highs.

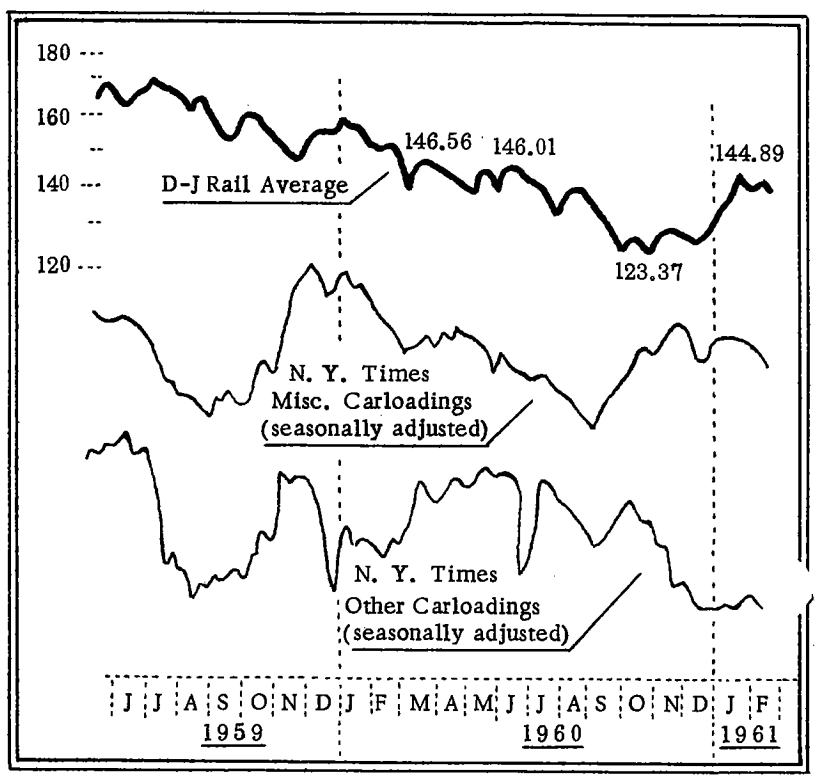
During an equally difficult period of price fluctuation (January, 1939) Robert Rhea wrote: "The words 'possibly', 'perhaps', 'usually' and 'probably' occur all too often in these discussions, but for a definite and valid reason. Nothing is certain about the Averages except that they are seldom static. Quackery can nearly always be recognized in discussions of the market by cocksure and dogmatic predictions." Again in June, 1939, Rhea wrote: "It is a basic tenet of Dow's Theory that the Averages must be allowed to tell their own story. The verdict cannot be hurried and, in the long run, it has proved good practice to avoid forming preconceived opinions of what the market 'is sure to do'."

In January, 1960, the majority of amateur and professional opinion held that the market was about to "take off" into the 750 to 800 area (spurred by the steel settlement and the dawn of a "New Era"). The market promptly broke in what was to be one of the worst first quarters on record. After denying the existence of a bear market throughout most of 1960, the majority opinion finally turned bearish when new lows were recorded by the Averages in September-October, 1960. Then as business worsened and the election neared, the consensus was that the market would head still lower, particularly if Mr. Kennedy was elected. The unexpected again occurred as both Averages turned up and bullish momentum was actually stepped up upon the election of Mr. Kennedy.

From all reports we are now on the threshold of a new bull market and a new period of economic expansion (which is supposed to start around the second quarter of this year). As of this writing, however, the market has not confirmed the bullish view.

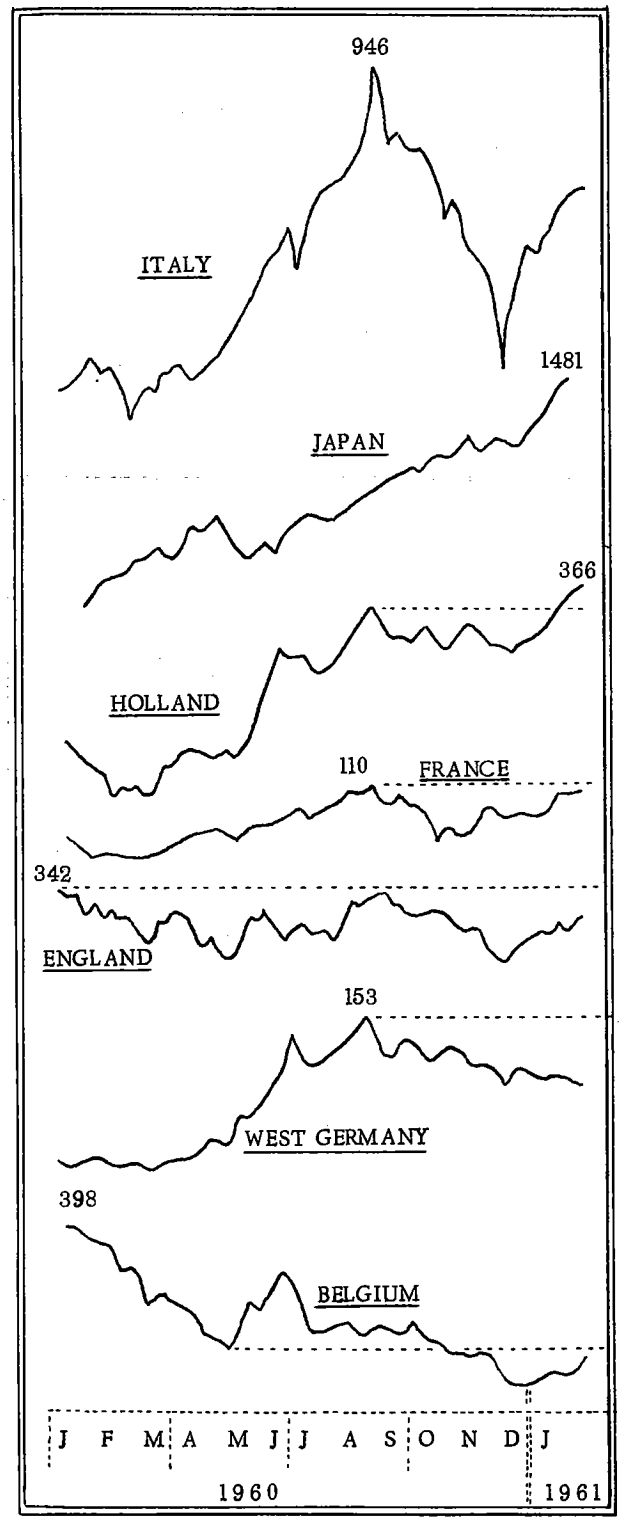
RAILS For eleven months I have been talking about the 146.56 point on the Rail Average, and subscribers are probably bored to death with both the Rails and the number 146.56. Nevertheless, this figure (recorded last year) represents the secondary peak established by the carrier Average following the bear signal; it is a level which (on March 25, 1960) pinpointed the market's appraisal of forthcoming Rail earnings and values. Obviously, the single greatest factor affecting those earnings was and will be rail freight or carloadings. Most of the rails have heavy debt structures and rather fixed expenses; for this reason increases or decreases in carloadings can exert great leverage on rail income. This fact is undoubtedly one of the reasons why rails are subject to generally wider price swings than industrials.

The chart shows the movements of the D-J Rail Average superimposed upon the N.Y. Times indices of "miscellaneous" and "other" carloadings. The former consists of steel and steel products as well as finished products. The "other" classification includes coal, coke, ore, forest products, grains, livestock, etc. A comparison of the movements of the Rail Average with the actual carloading statistics shows how accurate the carrier Average has been in its ability to discount forthcoming shipping and transportation trends.



As interpreted by Dow's Theory, the Rails have been non-commital for five months regarding the next important trend in carloadings. If the Rail Average betters the 146.56 point (and Industrials confirm) the market will be saying that the outlook for shipping and transportation is better than at any time since early 1960; moreover, it will be saying that the trend of shipping and manufacturing is "up" again. Conversely, if the two Averages turn down and violate the bear market lows of September-October, 1960 (Industrials 566.05, Rails - 123.37), the market will be saying that President Kennedy,

Mr. Heller and Mr. Samuelson have been unsuccessful in their effort to "get the country moving again".



FOREIGN MARKETS Letter 129 contained a chart showing the movements of the major foreign stock averages over the last year. At that time I stressed the thesis that all primary movements and most important secondary movements tend to be international in scope. Perhaps because readers in this country are becoming more internationally minded, perhaps because we have added a good many foreign subscriptions lately, I received many letters requesting periodic reviews of overseas markets.

The accompanying chart shows the latest profiles in international stock averages, and I consider this study to be particularly important because the U.S. economy is now more closely inter-related with world economies than at any other time since the turn of the Century.

The Italian market has bounced back about halfway since the 1960 "crash" (which literally cut Italian stock prices in two). Japan has one of the two world markets which is in new high ground, and speculation there has reached the stage where common stocks are now being marketed in Japan's department stores! The other interesting development is a new high in the Dutch market, a high which has strangely received little comment in the press.

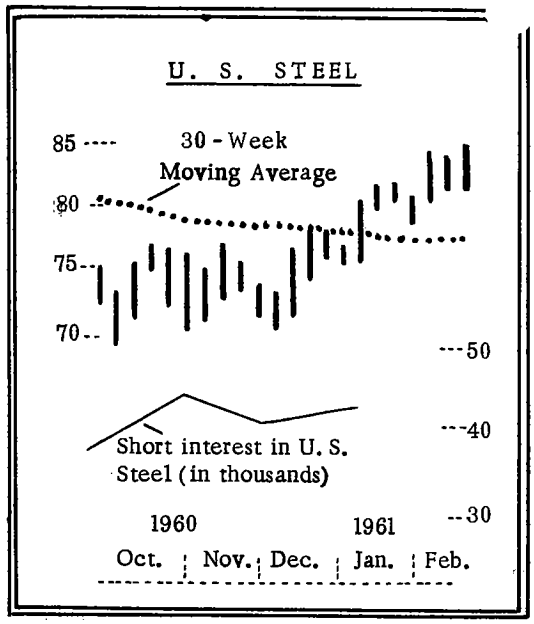
The French stock average has climbed back towards its 1960 high but so far has not given an upward penetration. England's market has acted somewhat like ours, and it has now regained about half of the losses sustained during 1960. Note that the mid-1960 peak on the British market did not better the earlier January high of 342.

West Germany, which has what is advertised to be the "strongest economy in the free world", is an enigma. It's average has been drifting downward with little sign (so far) of any of the type of strength exhibited by Holland or Japan. Belgium's market had obviously discounted much of the Congo mess, and it has been pushing up half-heartedly ever since the Belgian "economy riots".

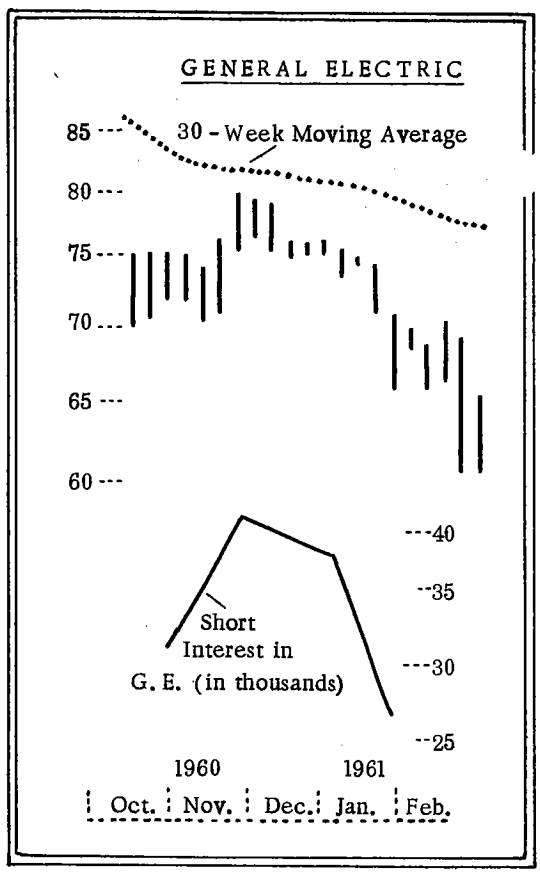
STOCKS Successful market practitioners can usually be divided into two classes: intelligent long-term investors and intelligent traders or speculators. I hope that the majority of my readers fall somewhere within these two categories. Among traders the constant problem is -- what do I do, and what are the odds if I do it? First of all, the odds are always with the investor or trader who (1) buys in a confirmed bull market, (2) stays out of a confirmed bear market. But there are times when the primary trend is

uncertain or obscure, and many long-term traders prefer to "take to the sidelines" when they are unsure of the trend. Traders do not have it that easy, however, and during periods of uncertainty they find that they have "to roll up their sleeves" and go to work.

One of the best ways to "work", in my experience, is as follows: keep weekly "high-low" price charts of a small (and easily handled) group of active stocks such as U.S. Steel, General Electric, General Motors, Anaconda and Eastman Kodak (all in the D-J Industrial Average). Experience shows that one-third to better than one half of the Dow stocks will lead (or at worst coincide) with the trend of the market. A 30-week moving average of each stock can easily be kept together with the monthly short interest figures for each issue. Statistics for the weekly high-low price may be obtained from Barron's each week (once a month Barron's publishes the detailed short interest statistics). The Friday closing figure may be used for constructing the 30-week moving average. As each new Friday figure is added to the 30-week total, the 31st-week figure is subtracted, and the sum of the most recent 30 Friday closings are then divided by 30. This provides a continuing average of the price of each stock during the past 30 weeks or approximately 7 months. I have found that a long-term price average is extremely valuable in determining the trend of a given stock. An interesting point is that many successful traders confine their activities to a small number of issues. A friend of mine trades almost exclusively in U.S. Steel, and he has been doing well with Steel for many years.



The chart of U.S. Steel (considered by many to be the most important stock on the "Board") illustrates the principles described above. Here we see Steel bettering its 30-week moving average in January, at which time the moving average was at 77.5. The short interest in Steel was about neutral, having held in the 40 to 44 thousand share range for three months. Thus the short interest in Steel was neither a plus nor a minus factor at the time, but if Steel can hold above its moving Average (now 77.8), and the short interest in Steel increases the trend for this stock will remain bullish.



The second chart shows the position of the nation's largest electrical equipment stock, General Electric. Any technician who got caught in the recent sell-off in G.E. should have known better. G.E. broke its moving average in July, 1960. During November and December, while the short position was dropping sharply, G.E. held above 75 and formed a bearish descending triangle. The final break finally came in January and February of this year. It is significant that all of G.E.'s recent bearish action took place while the stock was well below its 30-week moving average. (Written: Monday, February 20th - 1:30 P.M.)

NOTICE: I have had many requests for logarithmic chart paper. For this reason I have had a special chart paper drawn up; it is 8 1/2" X 11", supplied with or without punched holes, printed on fine-grade part-rag paper. Not only is the price movement section ruled in logarithmic or ratio scale, but the volume section is ruled in logarithmic scale as well. Obviously, an increase in volume from 2 million shares to 3 million shares is more important than an increase from 4 million to 5 million. Only logarithmic volume will show this difference. The paper is divided into five-day weeks and is suitable for use in recording the Averages or for plotting price movements of individual stocks. Price -- 10 sheets for $1.00, mailed first class and packed flat.